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Message Text

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ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 NSCE-00 TRSE-00 EB-04 SP-02
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C O N F I D E N T I A L LISBON 1861

LIMDIS

E.O. 11652: XGDS-3
TAGS: EFIN, ECON, PO
SUBJECT: PORTUGUESE/IMF NEGOTIATIONS

REF: STATE 62984

1. I AM PLEASED TO CONCUR WITH THE APPROACH OUTLINED IN PARA 4 OF REFTEL. WE BELIEVE THAT PORTUGAL AND THE IMF MUST REACH AN AGREEMENT PROMPTLY IN ORDER TO MAXIMIZE THE PSYCHOLOGICAL AND FINANCIAL BENEFITS OF SUCH AN ACCORD. ONLY AN EARLY AGREEMENT WILL SIGNIFICANTLY STENGTHEN THE GOVERNMENT'S IMAGE AND AVOID HEAVY SPECULATION AGAINST THE ESCUDO.

2. WE FEEL THAT THE FUND MISSION SHOULD RETURN TO PORTUGAL ASAP AFTER RECEIVING AN INVITATION FROM THE GOP. IF IT DOES NOT, WE SEE NO PROSPECT OF AN AGREEMENT BEING CONCLUDED IN THE IMMEDIATE FUTURE. WE DO NOT ANTICIPATE, FOR EXAMPLE, THAT THE GOP IS LIKELY TO IMPLEMENT MEANINGFUL CHANGES IN ITS INTEREST RATE AND EXCHANGE RATE POLICIES WITHOUT FURTHER DISCUSSION WITH THE FUND. SIMILARLY, WE DO NOT BELIEVE THAT THE FUND WOULD BE WILLING TO COMPROMISE ON ITS RECOMMENDATIONS WITHOUT FURTHER NEGOTIATIONS. IN ACCEPT-
ING PORTUGAL'S INVITATION TO REINITIATE NEGOTIATIONS, HOW-
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EVER, WE WOULD EXPECT THE FUND TO STRESS THAT IT WILL DO SO IN ORDER TO DISCUSS THE DEGREE, RATHER THAN JUST THE DESIRABILITY, OF FURTHER GOP ACTION.

3. THE FUND MISSION SHOULD DEFINITELY TELL THE GOP THAT IT IS ACTING UPON, AND IN CONCURRENCE WITH, ADVICE FROM MAJOR PARTICIPATNS IN THE COORDINATED LENDING PROGRAM.

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WE WOULD PLAN TO REINFORCE THAT MESSAGE BY STRESSING OUR BELIEF TO THE GOP THAT FURTHER MOVES ARE REQUIRED IN THE FOREIGN EXCHANGE AND INTEREST RATE AREAS. WE WOULD HOPE THAT THE IMF MISSION, CONTRARY TO ITS NORMAL PRACTICE, WOULD PLAN TO MEET WITH US AND WITH EMBASSIES REPRESENTING THE OTHER MAJOR PARTNERS IN THE COORDINATED LENDING PROGRAM. SUCH A MEETING WOULD HELP PROVIDE US AN ACCURATE PICTURE OF THE NEGOTIATIONS, ENABLING US TO MAKE AN INDEPENDENT JUDGEMENT ON THE RESPECTIVE POSITIONS OF EACH SIDE.

4. AS STATED IN LISBON 1623 AND LISBON 1624, WE CONTINUE TO BELIEVE THAT THE GOP SINCERELY DESIRES TO CONCLUDE AN AGREEMENT WITH THE FUND. WE FEEL ALSO THAT POLITICAL CONSIDERATIONS ARE, AND WILL CONTINUE TO BE, A MAJOR CONSTRAINT ON THE GOP'S ABILITY TO CONCLUDE AN AGREEMENT. COMPROMISE BY BOTH THE PORTUGUESE AND THE FUND MAY ULTIMATELY BECOME NECESSARY. IN ORDER TO MEET THE PORTUGUESE POLITICAL REQUIREMENTS WITHOUT SIMULTANEOUSLY UNDERMINING THE ECONOMIC EFFECTIVENESS OF THE ACCORD, THE FUND MAY WISH TO EXPLORE THE FOLLOWING POLITICIES, POLICIES WHICH WOULD PROVIDE AN ECONOMIC BENEFIT WITHOUT CAUSING UNACCEPTABLY HIGH POLITICAL RISK.
A. ESTABLISH STRICT CREDIT CEILINGS FOR EACH OF THE COMMERCIAL BANKS AS A PARTIAL OFFSET FOR PRESISTEN GOP OPPOSITION TO RECOMMENDED INCREASES IN INTEREST RATES.
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B. AUTHORIZE NO FURTHER INCREASE IN BANK OF PORTUGAL DISCOUNT RATES IN ORDER TO REDUCE INTEREST COSTS TO THE CENTRAL GOVERNMENT BUDGET. THE VOLUMEN OF DISCOUNTS TO INDIVIDUAL BANKS WOULD BE CONTROLLED ADMINISTATIVELY.
C. STAGGER THE IMPLEMENTATION OF INCREASED INTEREST RATES, WITH THE SHARPEST INITIAL INCREASE AFFECTING DURABLE CONSUMER GOODS.
D. REDUCE FINANCING TERMS FROM 24 TO 12 MONTHS FOR AUTOMOBILES AND 12 TO 6 MONTHS FOR OTHER DURABLE GOODS.
E. ESTABLISH SUBCEILINGS FOR CREDIT CREATION, ESPECIALLY FOR PUBLIC SECTOR ENTERPRISES.
F. PRESS FOR A FURTHER REDUCTION OF SUBSIDIES TO BANKRUPT ENTERPRISES.
G. SET A VOLUME TARGET FOR ATTRACTING FOREIGN INVESTMENT DURING THE PROGRAM PERIOD.
H. DETERMINE A SCHEDULE FOR TERMINATION OF GOP INTERVENTION IN PRIVATE COMPANIES AND FOR THE SALE OF COMPANIES WHICH THE GOP NATIONALIZED INDIRECTLY AND NOW HAS NO INTENTIONS OF RETAINING.
I. PERMIT GOP TO DEVALUE THE ESCUDO THROUGH A CRAWL, INITIALLY VERY FAST, RATHER THAN THROUGH A DISCRETE DEVALUATION THAT WOULD HAVE SERIOUS POLITICAL AND

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ECONOMIC REVERBERATIONS.
BLOOMFIELD

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